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Citation: Collins, D. A. (2017). Negotiating Brexit: The Legal Basis for EU & Global Trade. UK: Politeia.

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Trading with the World and the EU: Next Steps for the UK

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I

The UK's Future Trade – Global and EU Options

Now that Art 50 of the Lisbon Treaty has been triggered and it is clear that the UK will leave both the European Union and the Single Market the UK should prepare its position with respect to international trade, both with the EU and with the rest of the world. From the outset there will be two principal, if separate, aims – to prepare for future trade with the EU and to prepare for trade with the rest of the world. There are therefore two scenarios to be considered, each of which will be expanded upon below:

Future UK- EU Trade: Two possible avenues:

A UK-EU Free Trade Agreement (FTA): This process, though likely to be more protracted than it had appeared initially in light of the fact that the Article 50 separation negotiations between the UK and the EU will not proceed in tandem with a UK-EU FTA, is nonetheless achievable within the next few years. Given the strategic importance of the EU as a trading partner for the UK, the negotiation of an EU FTA covering both goods and services is a top priority. From a legal standpoint due to the complexity of some of the issues (notably product standards and financial services), it will be somewhat complicated, but there is no reason to believe that this will not be achieved in the near future.

UK-EU Trade Under the WTO Framework: If the EU does not agree to a FTA with the UK, then the second option would be to trade with the EU under the framework of the WTO.

FTAs with Other Countries:

The UK has indicated that it intends to pursue bilateral and possibly regional FTAs with other countries, including notably those of the Commonwealth and the United States. This is a sensible strategy and while FTAs are never easy, it is likely that the UK will enjoy reasonable

success in concluding these arrangements given its strong economic position and the fact that, unbridled from the EU, it will be able to pursue agreements without needing to make compromises in favour of other member states in the bloc. Until that time, trade terms with the rest of the world will be under the framework of the WTO, irrespective of which route is agreed with the EU.

Trade Terms:

World Trade Organization (WTO): Trade terms will therefore be under the framework of the WTO going forward for the rest of the world, and is one option for future trade with the EU if no EU-UK FTA is reached.

The UK must prepare its WTO position as an autonomous member within the 2-year time period specified by the Article 50 procedure. Given the major achievements of the WTO in removing barriers to trade, this is a reasonably straightforward and economically desirable position but there are a few issues which must be resolved. Although misleadingly described as a “no deal scenario”, the WTO is the umbrella under which most global trade is conducted including that which takes place between all those countries which do not have FTAs with each other, like the US and the EU and Australia and the EU. The WTO would continue to operate along with the future UK-EU FTA, however the FTA would presumably offer even better trade terms than exist under the WTO, including most likely lower tariffs and deeper market access for more services. Unlike the current situation, however, neither the UK-EU FTA nor the WTO scenario would be under the jurisdiction of the ECJ.

II

Trading with the EU: the options for future EU/UK trade

UK-EU Free Trade Agreement (FTA): Goods

Much of the focus in the national debate has been on the free trade agreement which the UK prime minister is proposing between the UK and the EU. A UK-EU FTA will involve agreement on a number of international trade factors such as goods and product standards, services and foreign investment. This section will consider such issues which will most likely arise during the negotiation of the anticipated UK-EU FTA.

Goods and Product Standards

First, under such an agreement the UK will seek to replicate as closely as possible the zero-tariff environment which existed through its membership in the EU. This will be of interest to both parties and should not be problematic. Article XXIV of the WTO's General Agreement on Tariffs and Trade (GATT) facilitates FTAs in which FTA parties grant preferential tariffs to those within it relative to other WTO members, which would otherwise violate the GATT's Article I Most Favoured Nation (MFN) obligation, obliging members to treat goods from all other countries the same as each other. The only requirements for an FTA are that there must be a notification to the WTO and, somewhat more problematically, that the FTA must cover "substantially all trade." The precise meaning of this phrase is not known, but we know that sector-specific FTAs would not be permitted. In other words, there could be no UK-EU Free Trade Agreement on Automobiles, for example. While some products could be excluded, the expectation is that the arrangement will cover almost everything.

Timing

One of the potentially problematic issues which appears to have arisen is timing. The indications from the EU are that the Article 50 negotiations will not proceed in tandem with a UK-EU FTA. There is no reason why this must be the case and the UK should seek to negotiate the FTA as part of the Brexit process if possible. If this approach fails, there could be at least some period of time when the UK will be neither a member of the EU or party to an FTA with the EU. This means that the UK will deal with the EU based on WTO terms (see further below) or that there could be some kind of transitional arrangement, in which the trade advantages of EU membership (or some of them) continue after the 2-year Article 50 period but before the

date at which an EU-UK FTA enters into force. One of the possible problems with this scenario is that it could leave the UK (and the EU for that matter) open to the accusation from another WTO Member that the UK and the EU are, through the “transitional arrangement” breaching the MFN principle under Art I of GATT by treating each other better than they treat everyone else without their being an Article XXIV-compliant FTA in place. However, Article XXIV(5) c) states that any such “interim agreement” should provide for the formation of an FTA “within a reasonable length of time”, meaning that it doesn’t have to be in place immediately. So a transitional arrangement with the EU, provided that it leads to an FTA reasonably quickly (perhaps 4 or 5 years) should be able to foreclose any MFN-based complaints from other WTO members.

Technical Barriers to Trade (TBTs)

One of the most difficult aspects of the goods component of the UK-EU FTA will undoubtedly relate to non-tariff product standards, otherwise known as Technical Barriers to Trade (TBTs) or Sanitary and Phytosanitary (SPS) measures in the case of foods. These have the potential to be quite controversial, given that one of the motivations for Brexit appears to have been the distaste within the UK for burdensome EU regulations which are often perceived as pointless and bureaucratic. The EU has famously resisted importation of a range of goods which do not fit with European understandings in relation to health (e.g. hormone treated beef and genetically modified organisms or biotech products) originating from countries like the US. It remains to be seen what stance the UK government will take on these matters, but presumably should the UK insist on its capacity to export such products to the EU (which is unlikely as few of these controversial goods actually originate from the UK) then there could be problems in concluding an EU FTA. It is most likely that the UK-EU FTA will resemble that of the Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada where there was agreement to recognize each other’s product standards, conforming to the WTO SPS and TBT Agreements. Under CETA the EU remains free to impose its own regulatory controls on products like hormone-treated beef and genetically modified organisms, both of which are produced in Canada. This did not require acceptance of the jurisdiction of the European Court of Justice over product standards by Canada, another non-negotiable position under Brexit.

Customs Arrangements

Another pressing concern following the UK’s departure from the EU will be customs arrangements regarding goods. Outside of the customs union, all goods traded between the two

countries will be subject to customs inspections and verification for rules of origin which is a key component of granting low-tariff access through an FTA. These procedures can be time-consuming and costly (adding several days and up to 10% to costs according to some studies). These issues are even more problematic for products which are part of production chains with components from several countries, like automobiles. The UK government has spoken of the desire for “frictionless trade” in goods. This could involve some kind of simplified customs procedures falling short of an actual customs union, possibly using a virtual border involving periodic customs self-assessments by exporters coupled with the use of information technology like bar code scanning. Furthermore, the EU would certainly require reassurance that the UK does not position itself as a “backdoor to the EU” by allowing goods into its territory from a third state which could then be shipped into the EU as if they were UK goods.

UK-EU Free Trade Agreement (FTA): Services

Services will be a key component of the UK-EU FTA, particularly the lucrative financial services market comprising industries like banking, legal, insurance, and accounting. Market access for financial services in the EU will be a crucial feature of the UK-EU FTA given its importance to the UK economy (over 10% of the UK’s GDP, £176 billion per year in value and over 7% of employment). The UK’s objective here will be to preserve the conditions which sustain the UK’s dominance in services, particularly since services are also becoming important for the UK’s manufacturing base. The Brexit White Paper indicated the UK’s intention of securing a comprehensive multi-sector FTA with the EU that provides the greatest possible access to each other’s markets, including services. Since the UK is not going to seek membership of the single market, this effectively precludes access via existing EU “passporting” or European Economic Area (EEA) models. The UK should be able to maintain its trade in financial services with the EU-27 based on a mutual recognition arrangement.

This would be a bespoke arrangement for reciprocal access for financial services, meaning that EU financial services firms would enjoy the same rights in the UK as those from the UK would in the EU. This could be achieved by the UK enacting all financial services regulations through the Great Repeal Bill which correspond to those of the EU, essentially duplicating the existing regulatory regime that was in place as a member of the EU. Falling short of full duplication of all EU financial services rules there could be a customized arrangement based on the understanding that the two regulatory and supervisory regimes were broadly consistent with each other in that they have common regulatory objectives and aim to

deliver comparable outcomes. This is somewhat less than strict “equivalence.” Focusing on outcomes should allow some flexibility in the position of both parties, particularly since financial sector regulatory regimes tend to evolve over time. In either case, the UK and the EU would also need to agree on a consultation mechanism should a change in the regulatory regime in one jurisdiction render this consistency in doubt. Since the UK has been a long-standing member of the EU and that there is a history of cooperation between the EU and its member states such an arrangement is quite feasible. The UK will wish to exclude the jurisdiction of the ECJ over financial services matters which will require some form of neutral arbitration mechanism, possibly modelled on the CETA’s Investment Court System could be achieved. Clearly the EU is willing to allow international courts to resolve disputes regarding foreign investment and there is no clear reason why something like this could not also be extended to financial services.

Mutual recognition for the regulation of financial services of the kind described above could be achieved under an FTA and concluded under Article 207 (governing the common commercial policy of the EU) and Art 218 (governing Free Trade Agreements) of the Treaty on the Functioning of the European Union (TFEU). It would also need to comply with Article V of the General Agreement on Trade in Services (GATS, the WTO agreement covering trade in services, of which more below). In this regard, it is important to note that GATS Art V, like GATT Article XXIV, requires “substantial sectoral coverage” which means that FTAs cannot be concluded on a sectoral basis – there can be no “Financial Services FTA.” All or near all services must be covered. So, in the event that the negotiations of the UK-EU does not progress rapidly on all areas, it would be feasible to create a Mutual Recognition Agreement for financial services on its own, apart from a full FTA. Unlike comprehensive FTAs in services (granting market access and non-discrimination), such arrangements may be sector-specific. These agreements must satisfy Art VII of the GATS, which allows WTO Members to recognize qualifications and standards of services suppliers originating from certain other members. There are no WTO rules on how such agreements must be structured, except that the parties must have included market access coverage for the relevant sectors in their GATS commitments. Both the UK and the EU have made extensive financial services commitments under GATS, having undertaken the Understanding on Commitments in Financial Services.

Protecting Foreign Investors: While foreign investment is quite distinct from trade it is important to address some key issues here as an FTA with the EU is likely to include an investment chapter. Freedom of establishment was one of the pillars of the single market and the UK will seek to create a future arrangement where its firms enjoy comparable conditions, just as it will wish to remain attractive to EU firms seeking a commercial presence in the UK. Some studies have suggested that foreign direct investment from Europe is at risk of shrinking post-Brexit and having an FTA with standard investor protections in place could help prevent this outcome. The agreement should accordingly contain guarantees against discrimination and unfair treatment as well as compensation in the event of expropriation which are standard in these instruments.

Dispute Resolution – Investor State Dispute Settlement (ISDS) v Investment Court System (ICS): There remains the highly contentious issue of dispute settlement for investment matters. Traditional investment treaties (which the UK was able to conclude before the Lisbon Treaty) contain Investor-State Dispute Settlement (ISDS) mechanisms, which permit private investors to bring claims directly against host states in international arbitration, with party appointed arbitrators – a system which has worked well for the UK over several decades. This process has become very controversial in recent years in part due to its perceived secrecy to the point that it is fair to say that there is a “backlash” against it. This was captured by the very negative response elicited from the EU Commissions’ public consultation on ISDS in the run up to the TTIP negotiations with the US. As a consequence the EU devised an Investment Court System (ICS) which consists of state appointed arbitrators (rather than party appointed ones, as under traditional ISDS) coupled with an appeal court of standing judges. The procedure will have enhanced transparency and the judges will be experts in international law, rather than in commercial matters as typically the case in normal ISDS. The Comprehensive Economic and Trade Agreement (CETA) between the EU and Canada contains this procedure and it would seem as though the EU intends to include the ICS in its future IIAs.

While the UK may not have much leeway to negotiate an investment chapter in its FTA with the EU without the ICS, to the extent that this is possible, until we have a better idea how the ICS will work in practice it would be preferable for the UK to avoid this mechanism in favour of conventional ISDS. The UK has an excellent track record in ISDS, having faced only one claim as a respondent in more than 40 years of investment treaty practice. British firms have won 13 of 27 cases they have brought against foreign governments, which is a

respectable success rate given that states normally win such cases. The ICS procedure will be expensive, most likely doubling the cost to participants, and it is not clear that it will add much in terms of consistency and predictability given that investment cases tend to be heavily fact-based and focused on achieving pragmatic solutions rather than the creation of a “system” of precedent in the manner of public international law. The judges to be appointed to the ICS court will require expertise in public international law but not necessarily knowledge of the relevant industries in which the disputes are focused. It should be noted that a recent ruling of the European Court of Justice has indicated that dispute settlement regimes for investors in FTAs are within the competence of EU Member states, which suggests that future FTAs may omit this feature entirely with a view to facilitating the ratification process (in light of the resistance presented by Wallonia to the CETA). This would mean that UK investors operating in the EU would be subjected to the jurisdiction of the ECJ, just as EU investors operating with the UK would be subjected to the UK courts.

Intellectual Property, Data Protection, Procurement and Competition. It should be recognized that a comprehensive FTA between the UK and the EU would also involve other matters such as intellectual property, data protection, procurement and competition. Given that UK laws in these spheres generally correspond to those of the EU already by virtue of the UK’s long-standing membership in the EU, it is expected that there will be limited legal difficulties in these areas, however there may be short-term pragmatic problems concerning the UK’s lack of institutional infrastructure to enforce some of these regulations. Difficulties with respect to procurement have been noted by commentators. Lastly, free movement of persons will almost certainly not form part of the FTA negotiations as the UK government has indicated that free movement will cease following Brexit and it is unlikely that it will be used as a bargaining chip, although the rights of EU nationals resident in the UK is presumably up for negotiation.

III

Free Trade Agreements with Other Countries

As a member of the EU, the UK was limited to the trade agreements negotiated by the EU. Because the EU reaches trade agreements on behalf of the bloc for each member state, a first task for the UK will be to prepare for trade with other non EU countries.

The aim should be to prepare for such trade agreements with other countries so all is ready upon the UK's departure from the EU after the two-year Article 50 period has ended. At that time the UK will be in a position legally to negotiate trade agreements with other countries. These will be optimal with respect to the UK's previous status under the EU because all prior EU agreements consisted of compromises among the various EU member states and their respective trade concerns. Situations like the near debacle with the CETA which took seven years to negotiate and was almost not ratified in the final days because of political pressures in Belgium, not to mention the evident failure of the TTIP with the US could most likely be avoided. Still, several legal issues will need to be resolved. This chapter will outline how to do this.

Trade in Goods

Goods and Products Standards - Prioritising tariffs' removal and product standards

The UK's trade agreements with other countries will prioritize the removal of tariffs on a wide range of goods, including some which had been protected in the past at the behest of other EU member states and for which there is no UK domestic market needing protection. These represent immediate efficiency gains which may well compensate for any losses engendered by declines in trade with the EU, which represents an ever-decreasing component of UK trade. A study by Open Europe identified more than £40 billion per year in under-traded non-EU markets. As a consequence of the success of the WTO/GATT regime, tariffs on most manufactured goods around the world is quite low, but some agricultural goods bear very high tariffs as do some manufactured goods such as automobiles, and these can be addressed bilaterally. Under Article XXIV of the GATT, FTAs may offer lower tariffs than those extended to other WTO members outside the FTA. But, as noted earlier, such FTAs must cover "substantially all trade" meaning that there cannot be sector-specific arrangements.

The issue of product standards regarding health and safety will be more complex and raise some difficulties from a negotiating standpoint. As noted above, it is not clear what stance the UK will take regarding certain controversial products like hormone treated beef or genetically modified organisms. This could present an obstacle to an FTA with a country like the US were the UK to insist on retaining EU-type restrictions on these products. As the WTO dispute settlement tribunals ruled against the EU's restrictions on both these classes of products the UK could follow global, scientific consensus and allow these products by recognizing US product assessment procedures, to the extent that they also conform to WTO SPS and TBT requirements.

Trade in Services

Sectoral agreement, investment treaties, other arrangements.

It is unquestionable that the UK's FTAs with the rest of the world will include services given that the UK exports £220 billion in services per year to the EU and the rest of the world and represents its key comparative advantage. Priority in this regard will be liberalizing financial services as well as securing mutual recognition agreements for professional qualifications to allow movement of services professionals on a temporary basis. *Recall that Article V of the GATS which facilitates FTAs, requires that such arrangements cannot be sector-based. GATS Art V requires "substantial sectoral coverage" which means that all or near all services must be covered in an FTA.* This means that the UK cannot conclude a Financial Services Agreement with Canada, for example, although it can conclude bilateral investment treaties (BITs) of which more will be discussed below. It should be pointed out here that Switzerland is often cited as a country which has concluded sector-specific agreements with the EU and that this is something which the UK could do either with the EU or other countries. However, the Swiss agreements, which are indeed sectoral (there is a Switzerland-EU Insurance Agreement) are not actually trade agreements. They are investment agreements which cover commercial presence establishment rights (only one of the three modes of services delivery). So they are not "caught" by GATS Article V.

Services negotiations in FTAs are bound to be more complex because of the highly regulated nature of this kind of economic activity. The UK's priority will be financial services and it will seek arrangements such as those indicated above in relation to the EU. Since, as noted earlier, the UK is very much a global leader in financial services regulation it is expected that the UK will be in a strong bargaining position with respect to setting the terms of such

agreements. A US-UK FTA could be somewhat more problematic in this regard given the US dominance and the evident intent of the new US government to de-regulate financial services going forward.

Another issue relating to services under a US FTA is the much-maligned liberalization of the NHS, meaning that public health services would be opened to supply by US firms. This is almost certainly a non-issue and appears to be a classic case of scare-mongering. The UK government recently clarified that public health would not be included in a FTA with the US (it would not have formed part of TTIP). This comes as no surprise given that the blueprint for international services treaties, the GATS, specifies (in Article I (3)b) that it does not cover “services supplied in the exercise of governmental authority” meaning a service “which is supplied neither on a commercial basis, nor in competition with one or more services suppliers.” In other words, it excludes public health services like the NHS. Virtually all FTAs with services chapters contain this kind of language and it is likely that the UK would conserve this approach in its FTAs with other countries, including the US.

Trade in Services Agreement (TiSA): Some mention should be made of the Trade in Services Agreement (TiSA) which is a FTA covering services currently being negotiated among 23 WTO Member States including the EU and many other developed countries. Together these countries comprise approximately 70% of world trade in services. TiSA is essentially an expansion of the WTO GATS (of which more below), meaning that the participants will commit to greater liberalization for their services than they did under GATS in part because, as developed countries, these parties have more interest in opening services than most WTO Members (two-thirds of which are developing countries) so negotiations on TiSA could proceed more efficiently than it would were 164 Members involved. The plan is eventually to incorporate the TiSA into the WTO with a view to it encouraging other WTO members to join incrementally. The last round of negotiations for the TiSA concluded in November 2016 and there is no set deadline to terminate the negotiations. The UK would be advised to proceed with negotiations under this agreement as an independent signatory after the 2-year Article 50 period ends, although there does not appear to be any indication that government intends to do this.

Promoting Foreign Investment

An FTA investment chapter and pursuing BITs. As suggested earlier, foreign investment is a vital component of the UK economy, with inward and outward FDI stocks roughly even at just

under £1 billion per year respectively. The UK has 97 Bilateral Investment Treaties (BITs) currently still in force, most of which are with developing countries. It is a party to the Energy Charter Treaty, which facilitates trade and investment in the energy sector. As indicated above in relation to the UK-EU FTA, the UK should include an investment chapter in its future FTAs with other countries offering foreign investors the basic protections contained in these treaties. It could also pursue BITs covering investment only without trade, as it did in the past before the Lisbon Treaty transferred this competence to the EU. Whether as part of FTAs or through BITs, the UK should take this opportunity to update its investment treaty practice from its Model BIT of 2008 in line with modern trends. These include providing clearer definitions of indirect expropriation and Fair and Equitable Treatment, the standard under which most investment claims have been brought. It would be advised to include provisions specifying the right to regulate in matters of public interest in order to foreclose claims based, for example, on regulations designed to address public health matters. Such precautions should not be viewed as interferences with normal market conditions in the UK, but rather insurance against frivolous claims, which, although rare, are best avoided.

Upholding standard ISDS As indicated above, the UK should avoid departing from standard ISDS in its investment treaties as this represents an attractive feature to foreign investors and could be advantageous to UK firms operating overseas in environments with weak rule of law. As many of the UK's future investment partners will be emerging and developing countries the importance of the procedural and substantive protections of investment treaties must not be underestimated.

Re-joining the European Free Trade Association (EFTA), leaving the European Economic Area (EEA).

Lastly, it is worth mentioning the possibility of the UK re-joining the European Free Trade Association (EFTA) consisting of Iceland, Norway, Liechtenstein and Switzerland. This would provide low tariff free trade in goods and services amongst these three countries (including the lucrative financial services market of Switzerland) and importantly would grant the UK access to EFTA's 27 FTAs with other countries (some of which contain services commitments), as well as the EEA. The EEA is a single European market of goods, services, capital and persons. Since the UK would not accept the free movement of persons component of this arrangement,

the UK could opt-out of the EEA like Switzerland. Switzerland has pursued relations on various matters with the EU on a bilateral basis, including a Switzerland-EU FTA.

IV

A Force for Trade Liberalisation: The World Trade Organisation (WTO)

The World Trade Organization (WTO): Role and position

In the absence of FTAs, UK trade with the non EU countries will take place under the WTO rules and the UK should now prepare for the trade arrangements ready to come into place as soon as it leaves the EU. Given that the WTO framework accounts for most of the world's trade and has a track record of success in removing barriers to trade, this is economically desirable and straightforward. It is important to acknowledge that the WTO is the framework for trade between the US and the EU (as well as between all other countries with which there is no FTA). The success of the WTO in promoting economic growth and increased standards of living around the world belies the attempts to dismiss it pejoratively as the “no deal scenario” in which the UK would operate in the absence of FTAs with the EU or with third countries. As mentioned below, WTO trade arrangements account for around 98 per cent of global trade.

An Instrument for Global Economic Governance and Progress The WTO is an international organization which was created in 1995 following on from the many decades of the GATT's operation as a stand-alone treaty. It currently consists of 164 countries, including the EU bloc and its member states along with the UK, as well as all of the world's major economies. Given that these many members represent a broad diversity of legal systems and regulatory cultures, the WTO's status as an instrument of global economic governance is truly astounding. The WTO's purpose, like that of the GATT before it, is to eliminate barriers to trade in goods with a view to raising standards of living. It now also covers trade services and intellectual property through its roughly 30 constituent agreements. More than 98% of world trade falls within the WTO's umbrella, making it a vitally important component of global commerce.

The WTO consists of a negotiating forum which pursues trade negotiations on a multilateral consensus basis and a dispute settlement body which issues binding legal judgments (called recommendations) and which authorizes enforcement through retaliation. The WTO court system has been described as the most successful international court in the world in terms of its caseload and compliance rates. Over the years the WTO regime has been remarkably successful in reducing tariffs, particularly on industrialized goods, which have

dropped from over 40% in the 1940s to less than 4% on average today. This was achieved through the WTO's main principles of tariff reduction, non-discrimination and transparency. It has also been able to control more modern forms of protectionism, such as subsidies and products standards, with comprehensive disciplines on all of these issues, although its efforts in liberalizing trade in services have been somewhat less successful. In recent years the WTO's multilateral negotiation process has proved less effective in terms of controlling trade protectionism, particularly in relation to agriculture. Its attempts to encompass other issues, like investment, appear to have been side-lined for the time being, although bilateral and regional movement on these areas has progressed. The recent Trade Facilitation Agreement, reducing procedural red-tape for border-crossings, has been a major success, revitalizing the WTO's mission going forward.

Although the WTO is widely regarded as one of the main drivers of poverty reduction in the developing world, with billions of people seeing a rise in living standards due to access to cheaper goods, the WTO is often also seen as a source of inequality in developed countries. It is erroneously viewed as a culprit in the rise in unemployment in manufacturing in countries like the US where politicians readily scape-goat the organization, along with FTAs, during election time. The reality is that most of the job losses in manufacturing are due to automation, not free trade, and that countries which are able to adapt to open markets and capitalize on their strengths have seen productivity increases. To the extent that some sectors have suffered (unemployment and wage suppression) because of exposure to the competition of world markets, reductions in the price of goods along with re-training efforts and adjustment programs, if delivered properly, can mitigate these losses.

Generally speaking, WTO membership lowers consumer prices and therefore has a beneficial impact on real wages and competitiveness throughout the economy.

Trading on WTO terms: The implications for the UK of trading only on WTO terms outside of the EU and before the conclusion of FTAs are broadly positive. Overall productivity would likely rise as the structures of production would become concentrated in non-protected sectors. The UK would no longer need to maintain tariffs on sectors which it has no significant domestic production to satisfy industrial lobbies elsewhere in Europe. Some have estimated that this would lead to a net gain to consumer welfare and GDP of 4 per cent. Furthermore, WTO membership would allow UK to abandon all EU regulations required by the single market, which some economists have argued should bring further efficiency gains in terms of GDP.

The UK became a member of the WTO on the day in which the WTO itself was born by virtue of its status as a contracting party to the original GATT from 1947. The UK accepted the WTO agreements in accordance with Article XIV:1 of the WTO Agreement by ratification on 30 December 1994. As the UK joined the EU in 1974, when GATT was updated in 1994, the EU annexed a schedule of concessions (specific trade commitments) for the UK, and all other EU Member States at that time. With respect to the services agreement GATS, the EU and its Member States including the UK jointly submitted a schedule of specific commitments.

It is widely held that the UK has a right to inherit the EU's rights and obligations with respect to the WTO based on the principle of customary international law reflected in Article 34 of the 1978 Convention on the Succession of States in respect to treaties, as well as under past practice under the GATT 1947. This means that upon its departure from the EU, the UK will possess all the rights and obligations of an original member of the WTO. It does not need to re-apply for membership, as some have asserted, although some of its obligations are unresolved, as will be explained further below. The EU will no longer be responsible for exercising the UK's rights (and obligations) as a WTO Member after Brexit – this will fall to the UK itself. Still, clarity with respect to these specific obligations and entitlements is crucial. Failure to clarify the UK's obligations under the WTO after the elapse of the 2-year Article 50 process could result in a situation where another WTO Member may feel aggrieved that its entitlements vis-à-vis the UK are not being fulfilled relative to the situation which existed prior when the UK was part of the EU. This could lead to a dispute against the UK through the WTO dispute settlement system – a situation which it would be best to avoid. There are a few issues which must be settled concerning the UK's membership in the WTO.

The UK and the WTO: Next Steps

Schedule of Tariff Concessions on Goods: What tariff rate for goods?

First there is the question of the UK's tariff concessions on goods. Article II of the GATT specifies that each WTO Member is bound by its schedule of concessions, meaning its tariff commitments on goods. As noted above, the EU annexed a schedule of GATT concessions on behalf of the UK when it joined the EU. The UK is accordingly legally committed to offer the EU bloc's bound tariff rates on all the listed goods, though it is free to offer lower tariff rates than these should it wish to do so. As such, the UK does not even need to "cut and paste" the EU's schedule of commitments – in a sense it has already done so. The UK will merely need

to re-state these in its own schedule of commitments (known as “rectification”) by extracting them from those of the EU.

There are the minor points that the EU’s schedule of tariff concessions is expressed in metric units of measure (not as ad valorem percentages) which could be problematic should the UK intend to return to the imperial system of measurement. Some concessions are expressed in Euros, which raises the spectre of an appropriate currency conversion rate should the UK wish to change to pounds sterling. The UK cannot unilaterally adopt an exchange rate to convert the specific duties designated in Euro to pound sterling neither can it convert the specific duties into ad valorem equivalents without negotiating with other members. It is worth noting that the EU was in the process of simplifying its own schedule of concessions under GATT. The UK could follow the EU’s lead and unilaterally simplify its tariff commitments by reference to a smaller list of categories of goods – the EU has promised it will reduce the list from roughly 27,000 to 300 for the purposes of clarity and legal certainty.

The UK’s Tariff Rate Quotas Sharing and Allocating its inherited quotas

There are two issues raised with respect to tariff rate quotas. First, there are the tariff rate quotas offered by the UK to other WTO Members. Under GATT Article XIII:2, the EU offered import tariff rate quotas (a certain percentage of goods entering at a lower than normal tariff) to other WTO Members. The EU has almost 100 tariff rate quotas, 86 of which are for agricultural goods, the largest portion of which are on meat. As an aside, the EU’s official schedule of tariff quotas have not actually been certified since the enlargement of the EU, which could potentially frustrate negotiations. When it leaves the EU, the UK will be required to share the burden of the lower tariff quotas offered by the EU to other WTO members. This would likely involve the UK reaching an agreement with all supplying WTO Members which have a substantial interest in exporting the various products into the UK at the lower than normal tariff rate. This could be complicated in that other countries may seize this opportunity to enlarge the number of tariff rate quotas which fluctuate from year to year. Brazil has apparently indicated that it will do this. New Zealand has a strong interest in demanding that the UK adopt a large share of the EU’s lamb quota as it ships more than half of its EU lamb to the UK. These quotas could involve negotiations with the EU-27 as members of the WTO, each of which should have the right to access UK tariff rate quotas on a non-discriminatory basis, if it has a substantial exporting interest to the UK. The UK-EU FTA may well address these issues with the UK possibly guaranteeing tariff free access to the relevant products with no quota or these issues

could be dealt with during the Article 50 process. Failure to resolve other WTO Members expectations regarding their ability to access the UK through its share of the tariff rate quotas promised by the EU through the various negotiations could lead to a complaint through the WTO dispute settlement system. Accordingly, the UK would be advised to forestall any such accusations by fulfilling other WTO Members' legitimate expectations regarding the UK's share. This could be achieved by unilaterally binding its normal tariff commitments on all products which were covered by tariff rate quotas over the last few years, such as lamb from New Zealand. All tariff concessions may be modified or withdrawn entirely under the procedure outlined in Art XXVIII of the GATT, which involves consultations with other WTO Members with special emphasis placed on negotiations with those Members which have a substantial interest in supplying the goods involved. All future changes would be reflected in the UK's schedule of tariff commitments discussed above.

Secondly and perhaps somewhat less importantly, there are the tariff rate quotas offered by other WTO Members *to* the EU, now minus the UK. These are the other side of the coin to those noted above. Again under Article XIII:2 of the GATT, importing WTO Members are permitted to allocate country-specific quotas on certain products. These are normally framed as "offers" because they give a better deal to exporters than they would get otherwise. As noted above, a tariff rate quota involves allowing a certain percentage of goods to be imported at a lower tariff rate, beyond which the higher (normal) tariff rate applies. So being able to access a given tariff rate quota is an advantage for an exporting country. While such quotas should be offered on a non-discriminatory basis (treating all other WTO Members the same) it is possible to negotiate agreements with specific WTO members based on their substantial interest in supplying that particular product. The UK will want to identify its share of tariff rate quotas offered by other WTO Members to the EU. It may be that the UK's post-Brexit export levels in certain products will be sufficiently large that taking advantage of these quotas will be commercially important and for this reason they should not be marginalized.

The EU's Agricultural Subsidies: Sharing the EU's Commitments

Agricultural subsidies are an enormous aspect of the EU's commercial and trade policy. The Common Agricultural Policy (CAP) which governs subsidies comprises something near 40% of the EU's total budget. The failure to curtail agricultural subsidies extended by developed countries like the EU and the US (and in so doing suppressing the natural competitive advantage of the developing world) has historically been perhaps the WTO's single greatest failure. The reality is, however, that without the WTO, agricultural subsidies in the EU would

be considerably larger and more distortive than they are today and for this the organization deserves much credit in eliminating much of this harmful feature of domestic economic policy.

The key issue for the UK after Brexit will be establishing its share of the EU's commitment *not to* subsidize its agricultural sector beyond the threshold set by the EU. *The UK, as with all other EU Member states, is entitled to subsidize its agriculture sector up to a certain degree (known as the Total Aggregate Measure of Support), based on the EU's obligations as a member of the WTO. This is the so-called Amber Box of agricultural subsidies specified under Article 6 of the WTO Agreement on Agriculture. These are subsidies which are considered to distort production and trade so should be minimized.* It is likely that this issue will not be significantly problematic, however, because as enormous as they still are, the EU's level of agricultural subsidies is only at about 7% of the total value which it is allowed (about 6 billion euros out of 72 billion per year across all agricultural products) and the EU (like all developed countries) is committed to phasing out its export subsidies on agricultural products by 2020 under WTO rules. In other words, there is quite a bit of room for the UK to extend lawful agricultural subsidies of the Amber Box variety based on the EU's commitment even with only a small share of the EU's allocation, whatever that level might be. The UK must negotiate its share of Amber Box subsidies following Brexit, likely based on its allocation of the CAP budget.

Still, the UK's share of the EU's right to subsidize could be problematic if it exceeded this entitlement, leaving itself open to a complaint from another WTO Member that the UK was unlawfully subsidizing its agricultural sector. The best way to deal with this issue is for the UK to establish a level of subsidization that represents the portion of the EU's agricultural subsidies which are currently granted to the UK or have been in the last three years as a representative period. This amount would be the UK's share of the benefits it derives from the EU's CAP. Alternatively, the share could be assessed based on the UK's contributions to the CAP, which are tied to its share of the EU GDP. It should be noted that the UK will still be free to subsidize its agricultural sector in other ways without WTO restriction (under the Agreement on Agriculture's Blue and Green Box subsidies respectively). The amount of money available to do so may change based on the UK's contributions to and drawings from the CAP as negotiated during the Article 50 process, but they do not engage WTO compliance issues. Following departure from the EU, a new regime for assisting UK farmers will probably need to be established, recognising that smaller and more vulnerable farmers will need to be helped. It might be a good opportunity to terminate other distortive and environmentally harmful subsidies on certain classes of farmers.

Services: Replicating the GATS schedule and allowing for greater liberalisation

Unlike the GATT, the GATS agreement is in large part voluntary, with each WTO Member specifying its commitments in terms of liberalization (essentially market access for services as well as the promise of non-discrimination against foreign services and service suppliers). This is in some way analogous to the GATT schedule of tariff commitments. The EU's GATS services commitments under Article XX were undertaken on an individual member basis: the EU's schedule of commitments specified different levels of services liberalization for each of the 28 Member States. The EU's GATS schedule sets out a framework for market access which is modified by each member's derogations in particular sub-sectors (horizontal) and modes of supply (vertical). Around 160 types of services are covered across the four modes of supply with varying derogations across the Member states, some of which are more onerous than others.

Again, as the UK exports about £220 billion and imports about £130 billion of services per year, maintaining an open trading arrangement in services with the rest of the world through the WTO will be crucial. The UK's under-performing services exports to non-EU countries like Canada and India are believed to be even larger than those relating to goods, representing massive potential gains post-Brexit. For example, the UK insurance industry has been poorly supported by the EU due to language barriers and legal differences. It is most likely that the UK initially will simply adopt its existing schedule of concessions within the EU's overall schedule as its own upon Brexit. This will involve extracting the various UK specific commitments from within the EU's certified schedule, which should be fairly straightforward, if time-consuming. Should the UK wish to make changes to its GATS services offer through a new services schedule after Brexit this will require a WTO certification procedure essentially involving notification. This should not be a problem so long as the UK does not decrease its overall level of services liberalization from its earlier status under the EU, which the UK is unlikely to do as it has a comparative advantage in most services and again, is expected to achieve significant export gains with many non-EU countries. Should the UK decrease its offer under GATS, however, then there could be an issue regarding breach of other WTO Members' legitimate expectations. Changes to GATS concessions, while permitted subject to notice, could result in arbitration through the WTO in order to ascertain appropriate compensation. The starting point for the UK post-Brexit would therefore be to replicate its GATS commitments as autonomous WTO member with a view to possibly modifying these going forward in line with objectives of greater market access liberalization.

With respect to the UK's supply of services to the EU (£59 billion worth of services are exported to the EU every year) GATS will represent significantly weaker market access than the UK currently enjoys as a member of the EU's Single Market. This is because very few WTO Members, including the EU-27 made significant GATS commitments to the rest of the world. Outside of the EU, UK services firms will need to examine the EU schedule of GATS commitments and each Member State's derivations from it to see what treatment they are entitled to. However, the GATS-only situation may not be as bad as is often thought because, since countries are free to apply more liberal services policies than they committed to under the GATS, many in fact do so. Actual services policy regimes among the EU-27 typically afford (much) better market access than what GATS schedules would prescribe. So market access and national treatment for the UK as a WTO member post-Brexit may appear to be somewhat worse compared to the status quo as an EU member yet in reality, it may not be as bad as a reading of GATS schedules might suggest. Of course applied regimes (which are extended on a Most Favoured Nation basis) lack the legal certainty of membership in the Single Market. Finally, it should be noted that the EU's schedule of GATS services is not complete – schedules for the 16 newer EU Member States have not been incorporated into the EU's commitments, so the extent to which the UK will be able to supply services into the EU purely on WTO terms is not readily discernible.

The Government Procurement Agreement (GPA): Options and procedures

The GPA is what is known as a plurilateral WTO agreement, which means that it is optional to existing (and future) WTO Members. It is important to recognize that the EU is a party to this agreement, not the UK, which means that the EU is responsible for fulfilling the obligations under the treaty, including those which are within the competence of its Member States. The UK will join as a signatory of the GPA upon its departure from the EU in accordance with the international law principle of succession of states noted earlier. Of course, the UK could decline to be bound by the GPA, in which case it would need to issue a declaration to that effect. Should the UK wish to reject its commitments under the GPA it would need to observe GPA procedures to do so, which would require notice and possibly carry the obligation to compensate other Members whose rights may be adversely affected by this action in the interim. Failure to follow these procedures could result in a claim through the WTO dispute settlement system. There is the further practical problem that the UK does not currently have the institutional infrastructure to fulfil or enforce GPA obligations (for example relating to

tendering procedures) and it will need to get this in order fairly quickly or else it will risk facing complaints by other WTO members for failure to uphold its GPA obligations.

The UK: What steps for adopting its own WTO commitments

Since the UK is already a WTO member in its own right, the process of the UK adopting its own WTO commitments for the future can happen in two ways: “rectification” or “modification”. The former is relatively simple, only requiring that no WTO Member state raises any objections to be approved, which is unlikely given the interests that most countries would have in continuing to trade with the UK under legal certainty. A full modification process on the other hand, would require rounds of negotiations over the scheduled tariffs, tariff rate quotas and services schedules and could take many years. Rectification is possible for rearrangements which do not alter the scope of a concession and other changes of a purely formal character. Modification of schedules implies the substantive change of a concession. The border between the two is determined by establishing whether the changes made will put another WTO member in a position worse off under the new rules than it was before Brexit. If the UK amended its schedules by means of a rectification of the EU’s schedules, the process could be completed in a few months. So long as the UK maintains the same tariff schedule as that of the EU, there would not be any great difficulty in classifying UK’s new schedule as a rectification of the schedule. If the UK changes its schedule substantively, for example by offering a lower level of liberalization than it did through the EU, then this could be viewed as a modification which would require a new tariff schedule, requiring the consensus of 163 members including the 27 countries that are also EU members. This scenario is both inadvisable and unlikely.

It should be recognized that the UK may avail itself of a WTO waiver if it is concerned that it will transgress its WTO obligations during or immediately after the Brexit negotiations. WTO members anticipating a breach of WTO obligations may request waivers by application citing the reasons which prevent the WTO member from achieving policy objectives. Under Article XI of the WTO Agreement, the waivers last for two years unless extended, which they can be, without limit. The function of a waiver is to relieve a WTO Member, for a specified period of time, from a particular obligation and are exceptional in nature, subject to strict disciplines. Waivers may be used to add flexibility to international law and in so doing deal with the tension between practical domestic needs and international requirements. This acts to relieve potential conflict by suspending the law before the tensions escalate to the point where

nations may be forced to use the dispute settlement system formally. Clearly Brexit is an exceptional situation and there is little doubt that it would justify a waiver. This could be used to cover any time gap between the UK leaving the EU and formalizing its schedules, allowing it to continue trading under current arrangements. It could also be used to neutralize the effect of any political blockage arising from one of more WTO members implementing reservations to any proposed schedule in the unlikely event this were to happen, allowing time for mediation and ultimate resolution. WTO members could conceivably allow both the UK and the EU transitional periods or temporary waivers to allow the negotiations to continue after the day of formal Brexit.

V

Conclusion

In the near future, the UK's agenda for making new trade agreements (with the EU and the rest of the world) will need to remain on hold until the departure from the EU is finalized through the Article 50 procedure, *although the UK government would be wise to get its position ready well in advance and make all possible preparations in the next two years short of starting formal negotiations with third countries.*

It is expected that the UK will pursue a transitional arrangement with the EU as part of the Brexit negotiation process, retaining some of its trade entitlements as an EU Member for a time while a formal FTA between the two states is established. Given that CETA took seven years to conclude, the negotiation and ratification of the UK-EU FTA itself likely to take perhaps 4 to 5 years from the point at which negotiations start, with an earlier conclusion if the discussions proceed in tandem with the Brexit negotiations. A rapid, more basic deal with less coverage seems to be unlikely given that the EU representatives have said that nothing will be agreed until everything is agreed. If for some reason a transitional arrangement is not agreed upon as part of the Brexit negotiations within the 2-year Article 50 period, or were the FTA negotiation process to drag on for several years (beyond the timeframe of a transitional arrangement) the UK will be able to trade as a member of the WTO both with the EU and with the rest of the world (before it concludes FTAs with other countries).

This should in no way be viewed as a nightmare “no deal” scenario, as many have warned. While some tariffs will be slightly higher vis a vis the EU, other tariffs will be lower and outside the single market the UK will be able to implement its own regulatory standards on goods and services internally and with respect to FTAs with other countries. Settling its position with the WTO raises some legal issues, but these should be resolved without serious difficulty. While there will unquestionably be a period of legal uncertainty for a time and it is unclear what the UK's future FTAs will look like, going forward the UK is in a strong position to negotiate bilaterally with other countries and to enjoy the benefits of free trade unbridled by the regulatory and political impediments posed by its status within the EU.

Checklist for the UK Government

Departure from the EU represents an extraordinary opportunity for the UK to take advantage of its economic strengths and its reputation as a robust and dynamic trading nation committed to rule of law and open markets. The UK can achieve mutually beneficial trading relationship with Europe based on common commitment to these principles. While trade agreements take time, an interim arrangement may be possible which will lay the groundwork for deep integration with Europe while preserving regulatory and judicial autonomy and restricting freedom of movement of persons. Should such an agreement with the EU not be immediately forthcoming, the UK will enjoy the low tariffs and market access offered through its status as a Member of the World Trade Organization. Unbridled from the EU and its complicated internal ratification procedures and multitude of interests across 27 member states, the UK will be well positioned to form favourable bilateral trade agreements with other countries leveraging its competitive advantages as required. A prosperous trading future outside of Europe is a realistic goal that should underpin the UK's negotiating position with the EU and other partner countries going forward. In the coming decades the UK will have many more trading opportunities with the rest of the world than with Europe and should not feel pressured into accepting trading arrangements with the EU which do not serve its needs as an independent nation.

1. Prepare its WTO Schedules of Commitments for Goods and Services – keeping those offered to other WTO Members at the same level it did as a Member of the EU. This should be framed as a “rectification” of its existing schedules – a formal change only. Tariffs on non-strategic sectors to be lowered from their EU level over time.
2. Prepare its position on its share of the EU's Tariff Rate Quotas, binding its past tariff commitments on all products which were covered by tariff rate quotas for the next few years.
3. Prepare its position on its entitlement to the EU's Aggregate Measure of Support for agriculture, likely to be based on the portion of the UK's contributions to the EU's CAP.
4. Enhance its domestic regulatory capacity for trade matters including customs procedures and procurement (as required by the GPA) taking advantage of new technologies. The UK should also set up its own national investigating authorities for anti-dumping, subsidies and safeguards

for the purposes of trade remedies under WTO law as these had previously been maintained by the EU. It makes sense to have these ready beforehand in the event that the UK seeks to pursue any such claims against other WTO members at some point the future.

5. Seek, as part of the Article 50 negotiations, an interim agreement based on the extension of existing entitlements as a Member of the EU in the run-up to the conclusion of an UK-EU FTA (in the event that this takes several years).

6. Negotiate a comprehensive FTA with the EU replicating as closely as possible the tariff-free access for goods, services and investment under the Single Market while avoiding ECJ jurisdiction and free movement of persons, as Canada achieved in CETA, but with even greater access given the UK's strong negotiating position and already deep regulatory integration with the EU.

7. In the alternative to #6 or if #6 takes several years, seek a Mutual Recognition Agreement for Financial Services based on common regulatory outcomes.

8. Upon expiry of Art 50 period, negotiate FTAs with strategic economic partners, starting with the countries of the Commonwealth and the United States where there is already evidence of some willingness.

9. Actively pursue trade negotiations under the WTO, TiSA, and other regional initiatives with a view to setting the agenda as a leader in global trade.

FURTHER READING:

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